MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Jump to the transcript of the questions and answers

Good afternoon, the Vice-President and I welcome you to our press conference.

Inflation continues to decline but is still expected to remain too high for too long. We are determined to ensure that inflation returns to our two per cent medium-term target in a timely manner. The Governing Council therefore today decided to raise the three key ECB interest rates by 25 basis points.

The rate increase today reflects our assessment of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission. The developments since our last meeting support our expectation that inflation will drop further over the remainder of the year but will stay above target for an extended period. While some measures show signs of easing, underlying inflation remains high overall. Our past rate increases continue to be transmitted forcefully: financing conditions have tightened again and are increasingly dampening demand, which is an important factor in bringing inflation back to target.

Our future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to our two per cent medium-term target. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will continue to be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission.

We also decided to set the remuneration of minimum reserves at zero per cent. This decision will preserve the effectiveness of monetary policy by maintaining the current degree of control over the monetary policy stance and ensuring the full pass-through of our interest rate decisions to money markets. At the same time, it will improve the efficiency of monetary policy by reducing the overall amount of interest that needs to be paid on reserves in order to implement the appropriate stance.

The decisions taken today are set out in a press release available on our website. The details of the change to the remuneration of minimum reserves are provided in a separate press release to be published at 15:45 CET.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

The near-term economic outlook for the euro area has deteriorated, owing largely to weaker domestic demand. High inflation and tighter financing conditions are dampening spending. This is weighing especially on manufacturing output, which is also being held down by weak external demand. Housing and business investment are showing signs of weakness as well. Services remain more resilient, especially in contact-intensive subsectors such as tourism. But momentum is slowing in the services sector. The economy is expected to remain weak in the short run. Over time, falling inflation, rising incomes and improving supply conditions should support the recovery.

The labour market remains robust. The unemployment rate stayed at its historical low of 6.5 per cent in May and many new jobs are being created, especially in the services sector. At the same time, forward-looking indicators suggest that this trend might slow down in the coming months and may turn negative for manufacturing.

As the energy crisis fades, governments should roll back the related support measures promptly and in a concerted manner. This is essential to avoid driving up medium-term inflationary pressures, which would otherwise call for a stronger monetary policy response. We welcome the recent Eurogroup statement on the euro area fiscal stance, which is consistent with this assessment. Fiscal policies should be designed to make our economy more productive and to gradually bring down high public debt. Policies to enhance the euro area's supply capacity can help reduce price pressures in the medium term, while supporting the green transition, which is also being furthered by the Next Generation EU programme. The reform of the EU's economic governance framework should be concluded before the end of this year.

Inflation

Inflation came down further in June, reaching 5.5 per cent, after 6.1 per cent in May. Energy prices fell again, dropping by 5.6 per cent, year on year. Food price inflation continued to slow but remained high, at 11.6 per cent.

Inflation excluding energy and food edged up to 5.5 per cent in June, with goods and services following diverging trends. Goods inflation decreased further, to 5.5 per cent, from 5.8 per cent in May. Conversely, services inflation rose to 5.4 per cent, from 5.0 per cent in May, owing to robust spending on holidays and travel and also reflecting upward base effects.

The drivers of inflation are changing. External sources of inflation are easing. By contrast, domestic price pressures, including from rising wages and still robust profit margins, are becoming an increasingly important driver of inflation.

While some measures are moving lower, underlying inflation remains high overall, including owing to the persistent impact of past energy price increases on economy-wide prices. Although most measures of longer-term inflation expectations currently stand at around 2 per cent, some indicators remain elevated and need to be monitored closely.

Risk assessment

The outlook for economic growth and inflation remains highly uncertain. Downside risks to growth include Russia's unjustified war against Ukraine and an increase in broader geopolitical tensions, which could fragment global trade and thus weigh on the euro area economy. Growth could also be slower if the effects of monetary policy are more forceful than expected, or if the world economy weakens and thereby dampens demand for euro area exports. Conversely, growth could be higher than projected if the strong labour market, rising real incomes and receding uncertainty mean that people and businesses become more confident and spend more.

Upside risks to inflation include potential renewed upward pressures on the costs of energy and food, also related to Russia's unilateral withdrawal from the Black Sea Grain Initiative. Adverse weather conditions, in light of the unfolding climate crisis, may push up food prices by more than projected. A lasting rise in inflation expectations above our target, or higher than anticipated increases in wages or profit margins, could also drive inflation higher, including over the medium term. By contrast, weaker demand – for example owing to a stronger transmission of monetary policy – would lead to lower price pressures, especially over the medium term. Moreover, inflation would come down faster if declining energy prices and lower food price increases were to pass through to the prices of other goods and services more quickly than currently anticipated.

Financial and monetary conditions

Our monetary policy tightening continues to be transmitted strongly to broader financing conditions. Risk-free interest rates over short to medium-term maturities have increased since our last meeting and funding has become more expensive for banks, in part owing to the ongoing phasing-out of the ECB's targeted longer-term refinancing operations (TLTROs). The large TLTRO repayment in June went smoothly, as banks were well prepared. Average lending rates for business loans and mortgages rose again in May, to 4.6 per cent and 3.6 per cent respectively.

Higher borrowing rates and the associated cuts in spending plans led to a further sharp drop in credit demand in the second quarter, as reported in our latest bank lending survey. Moreover, credit standards for loans to firms and households tightened further, as banks are becoming more concerned about the risks faced by their customers and are less willing to bear these risks. Tighter financing conditions are also making housing less affordable and less attractive as an investment, and demand for mortgages has dropped for the fifth quarter in a row.

Against this background, the annual growth rate of lending continued to decrease in June, falling to 3.0 per cent for firms and 1.7 per cent for households, with annualised growth rates of 0.0 per cent and -0.2 per cent in the second quarter respectively. Amid weak lending and the reduction in the Eurosystem balance sheet, the annual growth rate of broad money fell to 0.6 per cent in June, with an annualised growth rate of -1.1 per cent in the second quarter.

Conclusion

Inflation continues to decline but is still expected to remain too high for too long. The Governing Council therefore today decided to raise the three key ECB interest rates by 25 basis points.

Our future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to our two per cent medium-term target. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, our interest rate decisions will continue to be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission.

In any case, we stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target and to preserve the smooth functioning of monetary policy transmission.

We are now ready to take your questions.

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Does the absence of guidance for September mean the Governing Council is equally open to another hike, to a pause or even to the conclusion that rates have already reached their peak? That would be the first. And the second one – I am wondering how much of your decision on lowering the remuneration of minimum reserves was driven by concerns over central bank losses.

Let me just remind you what we have been doing. And I will come to your interest, which is what happens next. But let me just remind you what we are doing, and what we have been doing. We are raising interest rates, all three rates by 25 basis points. And this is the ninth decision to hike that has been taken in a matter of one year. So invariably, on meeting after the other, we have raised rates. The DFR is now at 3.75. And this decision that was unanimously agreed amongst all members of the Governing Council is driven by one key determination, which is to bring inflation to target, our target, which is medium-term inflation. There is unanimous determination to do so. What we have decided as well, and I will come to your minimum reserves remuneration as well, because that was your second question. We have also decided, and I'm going to quote, because it is a sentence that you might hear over and over, not only this time, but also next time and future times. We say "our future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to our 2% medium-term target. So, some of you may have noticed a slight change of a verb. And that is not just random or irrelevant. And I think it is predicated on our determination to be data dependent. So, I have said on many occasions that we had ground to cover or that we have more ground to cover. What I am saying here is that data and our assessment of data will actually tell us whether and how much ground we have to cover. So we are deliberately data-dependent and we have an open mind as to what the decisions will be in September and in subsequent meetings. Because this determination based on data might vary from one month to the other. So we might hike and we might hold, and what is decided in September is not definitive. It may vary from one meeting to the other. So I hope it is very clear that we are not in the domain of forward guidance but we are very strongly rooted in our determination to break the back of inflation and to take inflation back to 2% in the medium term on a sustainable basis. And to do that, we will be informed by data, we will analyse the data and we will then decide at that point in time. We will have the inflation outlook, we will have two readings of inflation with all the underlying dissection and understanding of it. And we will have even more understanding of our monetary policy transmission. And that will be repeated every Governing Council after every Governing Council, so that we can make sure as I said that we break the back of inflation.

Now, on your second question. Our primary job is to set monetary policy so that inflation stabilises at 2% over the medium term. No dispute about that. But we also have a public duty to make the implementation of our monetary policy as efficient as possible. So by cutting the remuneration on minimum reserves only, that's the basis that we will use. Cutting it to zero, we will reduce the amount of interest that we pay, which means the implementation of our policy is going to be more efficient. At the same time, it is going to have no impact on our policy stance, which is currently determined by the remuneration not on minimum reserves, but on excess reserves, which as you know are far more plentiful than the minimum reserves. So that is the decision that we made. More efficiency and that's also of course predicated on the principle of proportionality.

I have a question on the discussion concerning the time lag of monetary policy decisions and the effect it will have on inflation, because you have of course tightened at a record pace now and there are discussions that one first has to wait a little bit to really see the materialisation of those rate hikes. So, how are discussions going on that front? And then I would like to know whether you have discussed accelerating the shrinking of your balance sheet and if not, whether this could be a topic for the so-called second half of the year.

Thank you very much for your two questions. I'll take the second one. We have not discussed the reduction of our balance sheet and we have obviously acknowledged that the balance sheet has been reduced. And it has been reduced as a result of, number one, the reimbursement of more than what was expected to be reimbursed under the TLTRO reimbursement in June, and also by the fact that we have not only stopped net asset purchases but we have stopped any reinvestments. So, the balance sheet of the ECB is reducing as a result of that. But we have not discussed any further reduction at this point. On your other question, as you know, transmission of monetary policy is one of the three metrics that we use in order to determine our monetary policy stance, the strength of monetary policy transmission. And we look at it that way. We see it essentially as a two-legged process. The first leg is transmission to financing at large. What is the impact on lending, lending for banks, lending by banks to both corporates and households? And we try to measure that as accurately as possible by looking at volumes of loans, by looking at rates, by looking at obviously the bank lending survey that many of you have commented on yesterday, which informs us about what banks anticipate and in which areas, in which directions they expect to either increase or reduce the volumes of loans and reassess their risks in relation to borrowers. So that's the first leg and there are clear indications that our monetary policy is transmitted though that channel. The next one, which is the second leg, is transmission to the economy and from financing to the economy. How quickly does that move, how efficient is it. And we are really now beginning to see transmission materialising, whether you look at investment in housing, whether you look at investment altogether, there is obviously a decline on those two accounts. Still too early and there is certainly more in the pipeline, but we are definitely seeing monetary policy being transmitted and being transmitted strongly. That's obviously the case for the first leg and it is now also beginning to be the case in the second one.

So at the last meeting, you said you were not even thinking about pausing. Would you repeat that today? The second question is would you agree with the line that has been repeated by many of your colleagues in the Governing Council that the risks of doing too little outweigh the risks of doing too much in terms of rate hikes?

You will have to understand something, which is that I am not repeating things if prompted. I decide to say what I want to say. Okay. So what I just said in response to the first question. I hope it was clear. But I just want to repeat it for you just to make sure that I am as clear as you would expect. We are moving to a stage where we are going to be data-dependent, and we will take the new projection by staff. We are going to take two new readings. We are going to take more information about how transmission has taken place and on the basis of that, we will determine whether we hike or whether we pause. But what I can assure you of is that we are not going to cut, that is a definite no! But on the other side, it could be hike, it could be a pause. And if it is a pause, it would not necessarily be for an extended period of time, because as I said, it will vary from meeting to meeting, because we continue to decide on a meeting by meeting basis every time informed by the data. I hope it is as clear as I can be, because we are, and that was absolutely endorsed by the Governing Council, which has validated this decision unanimously, determined to operate on that basis. Voilà! Your second question, I have forgotten. You always ask something that I should repeat or that I should endorse but I am not doing that, sorry. You know, if my colleagues take this view or another, that's fine. And they can certainly be free to expand in one way or another. But I can assure you that on the occasion of today, it was a unanimous determination. The determination is rooted in one very simply direction: 2%. We want to break the back of inflation. 2% is the goal and we will get there, come what may.

I have two questions. Actually one is on financial stability. Do you consider European commercial real estate as a matter of concern? And the second one, can you elaborate more in detail about the spiral between wages and prices and inflation?

De Guindos: Good afternoon. With respect to commercial real estate, it is quite clear if you look at our financial stability review that we have paid a lot of attention to commercial property and to the decline in prices. This decline in prices started even before the tightening of monetary policy. And you know, the different agents and players that are exposed to commercial property market are mainly non-banks. So it is something that we pay attention to, that we have analysed in the past. And there is a clear divide between commercial and residential property. In the case of residential property, we have not seen any decline in prices but what we have seen is a slowdown in the evolution of prices. But commercial property is something that we have paid attention to and will continue to pay attention to in the future.

Lagarde: And on your second question, I think you raised the question of the potential risk of second round effects. Let me just take you back for a second, because it is a matter that we have reviewed, that staff are doing a lot of work on and that we have discussed. It is the role of wage growth and the role of profit margins as two key drivers of inflation, which are gradually eliminating the external causes that were prevalent before. The wage increases are definitely playing an increasing role as a driver of inflation and so have profit margins. On the profit margins front, we are seeing a slight decline in the first quarter of 2023 and as you may remember, our projection is also predicated on the fact that profit margins are wide enough to accommodate the squeeze that will be needed in order to allow for wage increases. But if we look at inflation expectations, if we look at how wages and profit margins are evolving, we are not seeing a second-round effect and for the moment at least, nothing suggests the risk of strengthening any second-round effects. But we are really monitoring that very carefully because, as you know, service inflation is the sort of hard nut to crack in terms of inflation, given that on goods it's going down, energy is coming out and it's negative. Clearly, we are focusing on services that are labour-intensive and that are also not as sensitive to interest rates. But we are looking at that very carefully and will continue to look at that extremely carefully.

Regarding the September meeting and the possibility of hiking or pausing, as of today, does the burden of the proof fall on an improvement of the inflation outlook, or will it be enough if the situation does not worsen? And a second question if I may: Spanish headline inflation is now in line with the mandate and the labour market is as hot as it has been for more than a decade. Is it something you would like to see for the full eurozone or is it necessary for the unemployment rate to go up for the ECB to stop hiking?

Do you mind me asking you to repeat what you said about the unemployment rate in Spain.

It’s at the lowest point for more than a decade.

Including for young people?

Yes, I was just saying that would you like to see that for the whole euro zone? I mean inflation going to 2% and unemployment being low. Or is it just not possible and the labour market has to cool down?

I’ll start with that one, your question about Spain, because it demonstrates the beauty of Europe and the heterogeneity that we have among the 20 countries that are members of the euro area. Obviously, the numbers that we see now for Spain, with inflation trending towards 2% and hopefully sustainably so, plus unemployment numbers that are as low as they have ever been, is a good set of numbers for the country and for the economy at large. It is not the same for all Member States and there are Member States where inflation is still very high and has been high and is expected to remain high for longer. So we have to be very attentive to the aggregate numbers. Those are the ones that are driving our inflation outlook, helping us determine our policy. But we also have to look at each Member State and the characteristics of each Member State. We shall see. Data will actually inform us better. But the hope that we have is that inflation will come down to 2% in the medium term. That is our primary mandate. As you know, we don’t have a dual mandate, unlike the Fed.

That’s what going to drive our determination. If we can do that with unemployment at the lowest level and staying there, that could be very good. It’s funny because you ask the question of a lawyer. The issue of the burden of proof is very often a lawyer’s issue. I think the burden of proof is going to be on the data. Because we are determined to bring inflation back to target, but we are also going to be in the hands of data and the assessment of data. So the burden of proof is going to be on data.

Two questions for you. First of all, how much do you think tighter monetary policy is contributing to the weakness in the euro zone economy that you identified? And secondly, what would it take in terms of reduction in your growth forecast and a reduction in your inflation forecast in September for you to pause interest rate rises?

What we are working on and what staff is trying to be as detail-specific and conclusive about is the impact of our monetary policy on inflation. So this is really what is the focus and what is driving us. What impact our interest rate hikes have produced, produce, and will produce on inflation. And obviously, the exercise of producing the inflation outlook that will be conducted in September by ECB staff will be very informative for the Governing Council to determine how much has been transmitted and what is expected to continue to be transmitted. As I said earlier on, in the financing leg, a lot has been transmitted. A lot. We know that. In the economy at large, not as much yet. And your second question is totally hypothetical, and I understand why you would want me to answer that question. But there are so many data and so much to take on in terms of the projection that will be produced in September, that I cannot answer your question in advance. We will really have to see.

You are suggesting a possible pause in rates in the near future. Does this mean that during this period of possible pause, we could see an acceleration of the QT. And then it would be like a trade-off among doves and hawks at the Governing Council?

Our key tool, our key instrument in the current circumstances, given the level of inflation that we have at the moment, is interest rates. So there will be no trade-off between either interest rates or QT. Interest rates are the main tool and the most efficient one. So it is the one that we will be using. There is the possibility of a hike, there is the possibility of a pause. It's a decisive maybe. But don't expect me to go one way or the other. As I said, the burden of proof is going to be the data and the ultimate point that we are determined to reach is the 2% inflation.

You've mentioned that several economic indicators recently have been weaker than expected and there are some economists warning already that the ECB is overdoing it with rate hikes, and they think that more patience would be necessary. So what's your response to that? And my second question. Climate activists criticize that the green bond purchases by the ECB under the new scoring system have largely stopped. Have you perhaps promised too much in terms of what the ECB can contribute to climate protection?

So we would be doing too much and promising too much. Look, doing too much is certainly not something that we are considering. What we are focusing on is the inflation numbers. We are committed to delivering 2% headline, medium term, on a sustainable basis, in a timely manner. This is our commitment. This is the drive of the Governing Council. When I look at headline numbers, when I look at core inflation numbers, when I look at all the many measures of underlying inflation, trying to really isolate the most robust element, and removing the most volatile part of it, we are seeing inflation that is still too high and that we project to remain too high for too long. So we have to do what we have to do, which is currently to hike. We know that we are getting closer, but we also know the options that are on the table: to continue to hike or to hold. And we also know that it will vary meeting by meeting because we want to be determined by the data and the analysis, and the assessment we make of the data. It's not surprising that it is transmitting to the financing channel. It is not surprising that there is less investment in housing. It is not surprising that there is less investment altogether. This is the intended impact of the monetary policy stance that we have determined. And this is precisely what will return inflation to target.

On the other point: have we promised too much? We have promised in our strategy review and subsequent decision, we have promised to be Paris Agreement-aligned. And obviously, as noted by all of you and as noticed by Greenpeace as well, we stopped any asset purchases under the Asset Purchase Programme, because we are no longer reinvesting. So as a result of that under the CSPP, we are not reinvesting. We are letting that portfolio into run-off mode. What we have decided is that we will stick to our commitment to be Paris Agreement-aligned, and we will in the course of 2023 elaborate the means and the ways by which we will be Paris-aligned. I just want to remind you, and this is not just to distract me for a second from the fight against inflation, but I just want to call your attention to the massive amount of work that is being done in the supervision arm of the ECB in order to really raise the level of awareness and the level of concern by banks and through banks by their clients. This is really beginning to work.

You say that the burden of proof is in the data for future decisions. What data is it that gives you more confidence that you may be able to pause and what data would you be looking at especially over the next months, that would stop those rate hikes? Is it core inflation, is it more that you are looking at the downturn in the euro zone economy and concerns about that? And my second question is about the US and the comparison with the euro zone. The US has raised rates significantly more than the ECB for a similar core inflation rate, or even the euro zone core inflation rate is slightly higher. The IMF, your former employer, said this week that the ECB might have more ground to cover, do you agree? Do you think that there is a suggestion that there might be more work to do in raising rates?

What data will be important? All data. And obviously we will be looking at all inflation data, starting with headline, we will have two readings before our September monetary policy Governing Council. We will look at core inflation, but we will go deeper into underlying inflation numbers to really appreciate and understand what is moving and what is steadily, sustainably moving. We know that some indicators are showing, particularly in goods, it’s pretty obvious, you look at producer prices, it’s pretty obvious. But when you start looking into services in particular, you have to really dissect those that are energy intensive, those that are interest sensitive, what share of labour there is in various segments of services. So we have to look into all that to understand whether the action that we have determined in the last year-and-a-half now, is really having a long-standing impact that will take inflation back to 2%. Don’t forget also that we will be looking at the inflation outlook that will be produced by the ECB, which will give us again the expected path of inflation, and the readings for 2024 and 2025 will obviously be very informative for us. We will look at labour numbers, we will look at investment numbers, we will look at just every single parameter of the whole economy of the euro area that we can look at in order to inform ourselves. I know it would be helpful for those who are using the same models, that are playing the same exercise, to understand from us that there is one particular specific indicator, one particular set of data that prevails over the others. No, it is not the case. We are looking at all of it and expectations are part of the picture as well.

The institution that I used to lead, the IMF, has updated its real April numbers and I don’t think that any of its terribly talented staff would argue with me that inflation in the United States and inflation in Europe are two different beasts, that are fueled by different drivers and in a context that is vastly different, both in terms of fiscal, in terms of labour market, in terms of energy and that certainly has something to do with explaining why figures are where they are. You know that better than anyone else, the Fed started a little bit earlier than the ECB and started from a base that was not negative interest rates either. You asked, do we have more ground to cover. At this point in time, I wouldn’t say so because as I said, the data we just discussed, and the assessment of data, will actually tell us whether and how much ground we have to cover in September and at subsequent meetings. And as I said in the early part of this press conference, it may vary from one month to the other.

I have two questions. One is on this message that you are conveying of the next meeting, that it could be a hike or a pause.

The next meetings.

And so compared to what we had up to now, that is a 25 basis points hike, coming to the next meeting, well, do you have a message to the European citizens that in the fight against inflation, you are getting closer to break the back of inflation? There is some good news in this announcement or these comments that you are making. And then the second question for me is on your assessment of the ECB euro area bank lending survey because it had some data on demand that was, I think, never seen in the past 20 years and so whether it was discussed at the Governing Council and it had an impact also on today's decision?

Yes, we are making progress. And I think the good news for European compatriots is that inflation is declining. You know we had a reading of 10.6% in October, we are now at 5.5%. But is that enough? Is that good as a result? Not quite. We have a target which is medium term 2% sustainable and we want to get there. But I'm sure that people when they do their shopping, when they fill up their tank, when they pay the gas bill, they see that the increase is not quite the same as six, seven months ago. Are we satisfied? Are we claiming victory? No, we want to go to the end of the game. The bank lending survey, yes, we looked at it carefully, it was debated with governors. And if you look at the monetary policy statement in the last paragraph that we have, it's very significantly described. The annual growth rate of lending continued to decrease in June falling to 3% for firms and 1.7% for households, with annualised growth rate of 0%, completely flat, and -0.2% in the second quarter, respectively. So not only are we seeing it very mildly grow year on year, but we are seeing a decline in the last quarter and the same holds for both corporates and households. So yes, of course, this is one of the elements of transmission that we have seen discussed and the fall in demand is also obvious, particularly on the part of corporates. A bit less so for households, but on the part of corporates, absolutely, absolutely yes.

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